

Committee on Ways and Means

Child Credit Refundability *Fact Sheet*

What is a refundable credit?

Most tax credits are nonrefundable. In other words, individuals are eligible for the credit only to the extent they have income tax liability. A credit is refundable if it is payable to individuals who have no income tax liability. The “refundable” amount of the credit is the amount that exceeds the individual’s income tax liability.

What was the child credit prior to 2001?

Prior to 2001, the child credit was \$500 per eligible child. The credit was not refundable for most families. However, for families with 3 or more eligible children, the credit was refundable to the extent the family had payroll tax liability that was not offset by the Earned Income Credit (EIC).

How was the child credit expanded in 2001?

The *Economic Growth and Tax Relief Reconciliation Act of 2001* significantly expanded the child credit in two important ways.

- (1) The law gradually increased the credit from \$500 to \$1,000. The credit was \$600 for 2003 and was scheduled to reach \$1,000 in 2010.
- (2) The law made the child credit partially refundable for all families with children – not just those with 3 or more children. The credit is now refundable by an amount equal to 10% of the family’s earned income in excess of \$10,000.¹ The \$10,000 threshold is indexed annually for inflation (it is \$10,500 for 2003), and the 10% refundability rate will increase to 15% in 2005.

How was the child credit expanded in the Jobs and Growth Law of 2003?

The *Jobs and Growth Tax Relief Reconciliation Act of 2003*, which was signed into law on May 28, accelerates the increase in the child credit. The credit will increase from \$600 per child to \$1,000 per child in 2003 and 2004. In 2005, the credit will revert to its 2001 Act phase-in schedule, and the 10% refundability rate will increase to 15%.

¹ Families with three or more children get the greater of payroll tax liability or 10% of earning income over \$10,000.

Who will benefit from the new law?

According to the Joint Committee on Taxation, 44 million children (27 million families) will benefit from the acceleration of the increase in the child credit. Some of these children will receive larger refundable credits because of the new law.

Criticisms from the *Very Liberal* Center on Budget and Policy Priorities

The Center on Budget and Policy Priorities (CBPP), *an extremely far left political organization*, recently released a 'report' arguing that 12 million children would receive more benefits if the new law included a provision to accelerate the increase in the refundability rate from 10% to 15%. Of this 12 million, 8 million receive no new benefits under the new child credit law and 4 million would receive higher benefits if the refundability were accelerated. However, several factors should be kept in mind.

- The new tax law includes several provisions that would benefit low-income families. The expansion of the 10% tax bracket and the increase in the standard deduction for married couples are both targeted to low- and middle-income families. Plus, \$10 billion in State aid was directed to Medicaid, the health care program for the poor.
- The new tax law takes an additional 3 million low-income families off the tax rolls entirely.
- The child credit provision in the new tax law IS refundable to the extent of 10% of earned income in excess of \$10,500. In 2005, the 10% rate will increase to 15%.
- Accelerating the increase in the refundability rate from 10% to 15% would affect families who pay no income taxes. In fact, these families generally have negative income tax liability because they are already receiving government payments from the Earned Income Credit and the refundable child credit that was enacted in 2001.
- Expanded refundability was not included in President Bush's \$726 billion tax proposal; it was not included in the \$550 billion tax proposal that passed the House, and it was not included in Chairman Grassley's mark. Instead, expanded refundability was added during the Senate Committee markup as a member item. With the exception of State aid, the final conference report does not include any narrow items or revenue raisers that were added in the Senate.
- Expanded refundability would not benefit all children – 14 million children would be left out. These children would continue to be left out because their family income is so low (less than \$10,500 of earned income) that they pay no income tax and qualify for many other anti-poverty programs OR these families' incomes are too high (more than \$75,000 of Adjusted Gross Income for single parents and \$110,000 for married couples with children).
- The partisan Democrats at the Center on Budget and Policy Priorities vehemently opposed any tax cut of any kind during the debate on the growth bill. Now they are arguing that the tax cut wasn't large enough for families who don't pay income taxes in the first place.

- Congress needs to expeditiously consider a significant expansion of the child tax credit.

EXAMPLES
Refundability of Child Credit for 2003

Example 1: Married couple earning \$30,000 with 3 children.

	<u>Pre-2001 Law</u>	<u>2001 Law</u>	<u>2003 Law</u>
<u>Tax Liability Before Credits</u>			
Earnings	30,000	30,000	30,000
Standard Deduction	(7,950)	(7,950)	(9,500)
Personal Exemptions	(15,250)	(15,250)	(15,250)
Taxable Income	6,800	6,800	5,250
Marginal Tax Rate	15%	10%	10%
Income Tax Liability	1,020	680	525
Payroll Tax Liability	2,160	2,160	2,160
Child Credit	1,500	1,800	2,475
Earned Income Credit	782	992	992
<u>Tax Liability After EIC and Child Credit</u>			
Income Tax Liability	0	0	0
Payroll Tax Liability	898	48	0
Payment from Government	0	0	782

Example 2: Single mother earning \$20,000 with 2 children.

	<u>Pre-2001 Law</u>	<u>2001 Law</u>	<u>2003 Law</u>
<u>Tax Liability Before Credits</u>			
Earnings	20,000	20,000	20,000
Standard Deduction	(7,000)	(7,000)	(7,000)
Personal Exemptions	(9,150)	(9,150)	(9,150)
Taxable Income	3,850	3,850	3,850
Marginal Tax Rate	15%	10%	10%
Income Tax Liability	578	385	385
Payroll Tax Liability	1,440	1,440	1,440
Child Credit	578	1,200	1,335
Earned Income Credit	2,888	2,888	2,888
<u>Tax Liability After EIC and Child Credit</u>			
Income Tax Liability	0	0	0
Payroll Tax Liability	0	0	0
Payment from Government	1,748	2,263	2,398